Response to Financial Services Growth and Competitiveness Strategy Call for Evidence

A healthy financial sector is an essential utility for a prosperous economy. Society relies on financial institutions to process payments, provide credit and investment in the real economy, and manage risk.

We therefore welcome the government's commitments to increase financial inclusion and promote a more diverse financial system, including by growing the mutual and cooperative sector.

There remains a widely-held view among economists, industry and the wider public that Britain's financial sector has grown increasingly detached from its core purpose of supporting the wider economy. In 1960 the UK banking sector's assets were equal to just 32% of GDP - as of 2022 this has increased to 563% of GDP. This expansion of the sector's size hasn't led to a corresponding increase in the growth rate of the UK economy - in fact it appears to have had the opposite effect.

In designing the UK's first Financial Services Growth and Competitiveness Strategy, the government should heed the wealth of empirical evidence showing that, beyond a certain threshold, financial sector growth harms the wider economy. Studies published by the IMF[1] and BIS[2] have found that more finance starts having a negative effect on output growth when credit to the private sector reaches 100% of GDP. As of 2023, credit to the private sector averaged 160 percent of UK GDP since 2000.[3] While there is some contestation in the literature, the pattern is clear: as a 2021 research study put it, "too much finance is robustly found to harm growth."[4]

Attempting to grow the financial sector therefore risks undermining the government's efforts to grow the economy. It poses particular risks to the government's wider industrial strategy and missions. An oversized financial sector pulls highly educated and skilled workers away from the research and development-intensive industries that offer the strongest potential for UK prosperity, and which an industrial strategy should be focused on.

Much of the growth of the financial sector does not represent the creation of new tangible wealth or additional economic value, but the zero (or even negative) sum appropriation of wealth created elsewhere in the economy. It is worth remembering that Britain's banking industry showed its fastest growth on record amid the credit crunch in 2008, as borrowing costs rose sharply for the rest of the economy.

As the financial sector grows, it typically does so by increasing leverage and excessive risk-taking, which, as history teaches us, ends in recurring crises. There is always a

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[1] Too Much Finance?; by Jean-Louis Arcand, Enrico Berkes and Ugo Panizza; IMF Working Paper 12/161
[2] BIS Working Paper No. 381: Reassessing the Impact of Finance on Growth
[3] Total Credit to Private Non-Financial Sector, Adjusted for Breaks, for United Kingdom (QGBPAM770A), FRED database, accessed Nov 30, 2024.
[4] How much should we trust five-year averaging to purge business cycle effects? A reassessment of the finance-growth and capital accumulation-unemployment nexus, Simon Sturn, Gerald Epstein, Economic Modelling, Volume 96, March 2021, pp 242-256.

temptation to think things are now different, and as memories of past crises fade, policymakers must not fall into the 'trap of complacency' and ignore the 'timeless nature of the threat', as the Bank of England governor himself recently warned.[5]

What is needed is not simply more finance, but better finance. The UK financial sector lends predominantly against existing assets and not towards the production of new goods and services, increasing an unproductive debt burden that drags on the wider economy. Lending to the real economy has consistently made up around just 10% of bank lending in recent decades. The vast majority - around 80% - of bank lending goes towards inflating the price of pre-existing property and other assets.

SMEs have been particularly poorly served by our financial system, receiving between just 2 and 5% of bank lending, despite providing 60% of private sector jobs in the UK.[6] The financing shortfall faced by SMEs was estimated to be £20 billion a year in 2013, and there is reason to think this gap has only widened.[7]

Recent data shows a worsening picture.[8] The stock of loans held by non-financial corporations is lower than it was in 2010, falling around half in real terms. Net lending to productive industries has been negative for the past three years.

Instead of seeking to increase the growth and competitiveness of the financial services sector as an end in itself, the government's strategy for finance should focus on ensuring it is adequately regulated and able to meet the needs of the wider economy, including the other target sectors identified in the government's industrial strategy.

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2. Mick McAteer (Co-Director, The Financial Inclusion Centre and former FSA and FCA Board Member)
3. Nicholas Shaxson (author, *The Finance Curse*)
4. Jesse Griffiths (CEO, Finance Innovation Lab)
5. Sue Hawley (Executive Director, Spotlight on Corruption)
6. Phoebe Clay (Director, Unchecked UK)
7. Josh Ryan-Collins (Professor in Economics and Finance, UCL Institute for Innovation and Public Purpose)
8. Jonathan Cave (Senior Research Fellow in Economics, University of Warwick)
9. Guy Standing (Professorial Research Associate, SOAS University of London)
10. Ellen Brown (founder, Public Banking Institute)
11. Sebastian Diessner (Visiting Fellow, London School of Economics and Political Science)
12. Sir John Kay (Emeritus Research Fellow, St John's College University of Oxford)
13. Martin O'Neill (Professor of Political Philosophy, University of York)
14. Damon Gibbons (Chief Executive, Centre for Responsible Credit)
15. Baroness Ruth Lister (Professor of Social Policy, Loughborough University)

[5] Today's challenges in Financial Stability: the new and the not so new - speech by Andrew Bailey | Bank of England
[6] Greening finance to build back better | New Economics Foundation
[7] Seizing the Opportunities from Digital Finance - Speech by Andy Haldane - Bank of England
[8] Briefing: How is bank lending shaping the UK economy? | Positive Money

16. Christine Cooper (Chair in Accounting, University of Edinburgh Business School)
17. Kate Pickett (Professor of Epidemiology, University of York and author, *The Spirit Level*)
18. Richard Wilkinson (Emeritus Professor of Social Epidemiology, University of Nottingham Medical School and author, *The Spirit Level*)
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20. Paul De Grauwe (John Paulson Chair in European Political Economy, London School of Economics)
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22. Andrew Sayer (Emeritus Professor of Social Theory and Political Economy, Lancaster University)
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35. Stefanos Ioannou (Senior Lecturer in Economics, Oxford Brookes University)
36. Dimitrios Asteriou (Reader in Economics, Oxford Brookes University)
37. Joseph Stiglitz (Nobel laureate in economics and University Professor, Columbia University)
38. Paul Langley (Professor of Economic Geography, Durham University)
39. Sarah Edwards, Executive Director, Just Money Movement
40. Will Snell (Chief Executive, Fairness Foundation)
41. Rebecca Gowland (Executive Director, Patriotic Millionaires UK)
42. Leah Downey (Research Fellow, St. John’s College, Cambridge University)
43. Irene Claeys (Policy Fellow, Grantham Research Institute, LSE)
44. Andy Agathangelou (Founder, Transparency Task Force)
45. Areeba Hamid (Executive Director, Greenpeace UK)
46. Christine Berry (author and independent researcher)
47. Malcolm Sawyer (Emeritus Professor of Economics, Leeds University Business School)
48. Will Stronge (Director, Autonomy Institute)
49. Mark E Thomas (Founder, The 99% Organisation)
50. Lord Prem Sikka (Emeritus Professor, University of Essex)